AMOCO PRODUCTION CO.

IBLA 76-706 Decided January 8, 1980

Appeal from decision of Director, Geological Survey, requiring corrected production reports and payment of additional royalty for gas produced from the Embar-Tensleep participating area and used as fuel for operations in the Madison participating area of the Elk Basin Unit Agreement, I-Sec. No. 439.

Reversed.

1. Oil and Gas Leases: Royalties -- Oil and Gas Leases: Unit and Cooperative Agreements

   Where the statute and operating regulations each provide that gas used for production purposes on the leasehold shall be excepted from royalty due the United States, it is error for the Geological Survey to require payment of royalty for gas produced from the Embar-Tensleep participating area and used in operations in the Madison participating area within the same leasehold under the Elk Basin Unit Agreement.

APPEARANCES: Louis C. Ross, Esq., and Frank H. Houck, Esq., Denver, Colorado, for appellant.

OPINION BY ADMINISTRATIVE JUDGE HENRIQUES

Amoco Production Company has appealed from decision GS-73-O&G dated June 9, 1976, wherein the Director, Geological Survey, affirmed the Area Oil and Gas Supervisor's decision of February 27, 1975, which required Amoco to furnish corrected production reports and to make additional royalty payments for the months that excess gas from the Embar-Tensleep participating area was used as fuel for operations within the Madison participating area, all within the area subject to the Elk Basin Unit Agreement, I-Sec. 439, Park County, Wyoming, and Carbon County, Montana. Amoco is the unit operator.

There appears to be no dispute over the facts in this case.

The Elk Basin Unit Agreement was approved effective June 1, 1943, pursuant to sections 17, 27, and 32 of the Mineral Leasing Act, as amended, 30 U.S.C. §§ 226, 184, and 189 (1976), and includes all formations within the Unit Area below the top of the Sundance formation. Under the terms of the unit agreement, separate participating areas have been established for each producing formation. Among these are the Embar-Tensleep participating area and the Madison participating area.

Gas produced from the various participating areas is processed through the Elk Basin gasoline plant, with the residue gas being returned to the operator. The volume of gas being produced from the Embar-Tensleep participating area is greater than is required for fuel purposes relative to operations in that participating area. Amoco has utilized gas produced from the Embar-Tensleep participating area to meet its fuel requirements in the Madison participating area, but has not paid royalty to the United States for such gas. 1/ Amoco contends that this use of gas is excepted from the requirement to pay royalty under section 21 of the Unit Agreement, and the operating regulations in 30 CFR 221.44. Survey disagrees with this contention.

The Elk Basin Unit Agreement provides in pertinent part:

> 5. Effect of Unitization: * * * The terms, conditions, and provisions of all of such [committed] leases, subleases, and other contracts are hereby expressly modified and amended to the extent necessary to make the same conform to the provisions hereof, but otherwise to remain in force and effect. * * * The parties hereto and consenting hereto hereby consent that the Secretary of the Interior shall, and he does hereby establish, alter, change or revoke the drilling, producing, and royalty requirements of federal leases committed hereto to conform said requirements to the provisions of this agreement. * * *
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> 7. Operating Committee: An Operating Committee composed of representatives of the Working Interest Owners shall be created under a separate operating contract concurrently entered into among the Working Interest Owners, and all matters relating to the selection, powers, and functioning of the initial Operating Committee or any subsequently formed operating committees are contained

1/ Amoco supplements its needs for fuel for operations in the Madison participating area by purchase of gas from outside the area of the Elk Basin Unit Agreement.

in said operating contract which provides certain limitations upon the powers of operator respecting its operations hereunder and in the respects therein set forth; provided, that no such limitation shall be deemed to limit in any respect the lawful powers of any federal or state administrative agency having jurisdiction secured to them by applicable law or lawful regulation or by the terms of this contract. The Initial Operating Committee created for the Embar-Tensleep Participating Area hereinafter defined shall be known as the Embar-Tensleep Operating Committee [sic]. Any operating committee hereinafter created to function in any additional participating area, in a formation other than the Embar-Tensleep, shall be appropriately designated to distinguish it from the Embar-Tensleep Operating Committee.

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9. Rights and Obligations of Operator: * * * Except as modified by the provisions of this contract, the Operator shall keep and perform the terms and provisions of all leases, subleases, and contracts only to the extent that they are applicable to any land and interests herein in the participating area committed to this agreement, and such other obligations as may be assumed by it under Sections 14 or 24 hereof. Otherwise such obligations shall be the obligations of the owners of the operating rights and lessees on each respective tract committed hereto.

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12. Cost of Operations: Operator shall, except as otherwise specifically provided herein, * * * pay all costs and expenses of development and operation with respect to the unitized land and no part thereof shall be charged to the Royalty Owners. * * *

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14. Testing Additional Formations - Additional Participating Areas: * * * Upon the approval of said new participating area a separate Operating Committee shall be created for that area. The Operating Committees for any two or more participating areas may, with the consent of the Secretary of the Interior and the Commissioner of Public Lands of the State of Wyoming, combine said participating areas into one, and in that event there shall be only one operating committee for the areas so combined.

18. Allocation of Production: All unitized substances produced from each participating area under this agreement, except any part thereof unavoidably lost, or allowed to the Operator royalty free as herein provided, shall be deemed to be produced equally on an acreage basis from the several tracts of land of any participating area subject to this agreement. * * * It is hereby agreed that production from any part of a participating area shall be allocated as provided herein, regardless of whether any wells are drilled on any particular tract or part of said area. * * *

19. Royalties: In each participating area royalties on each tract shall be paid or delivered by the parties obligated therefor as provided by existing leases, contracts, laws, and regulations, at the lease or contract rate upon the unitized substances allocated to the lease or tract. Unitized substances produced from any participating area and used therein in conformity with good operating practice for drilling, operating, camp, or other production or development purposes or under an approved plan of operation for repressuring or cycling said participating area shall be free from any royalty or other charge, except as to any products extracted from gas so used. If Operator introduces gas into any participating area hereunder from sources other than such participating area for use in repressuring, stimulation of production or increasing ultimate recovery in conformity with a plan first approved by the federal Oil and Gas Supervisor, a like amount of gas may be sold without payment of royalty as to dry gas but not as to products extracted therefrom, * * *.

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21. Government Royalties: Royalty due the United States on account of federal lands subject to this agreement within the unit area shall be computed as provided in the operating regulations; provided, that for leases on which the royalty rate depends on the daily average production per well, said average production shall be determined in accordance with the operating regulations as though all the unitized lands within the participating area were a single consolidated lease; * * *.

The Operating Regulations are contained in 30 CFR Part 211. Pertinently they provide: "§ 221.44 Measurement of Gas. Gas of all

kinds (except gas used for purposes of production on the leasehold or unavoidably lost) is subject to royalty, * * *."

The Geological Survey contends that under section 5 of the Unit Agreement, the signatories consented to modification of the terms of the Federal oil and gas lease to conform to the provisions of the Agreement, and that section 19 of the Agreement clearly provides that the only gas free of royalty is that which is used for production purposes within the participating area from which it originated.

Amoco argues that section 21 of the Unit Agreement governs the situation, and that the royalty due the United States is to be determined solely as provided in the operating regulations, which clearly excepts gas used for purposes of production on the leasehold. We agree.

Section 17 of the Mineral Leasing Act, as amended, 30 U.S.C. § 226(b) (1976), provides that royalty due the United States shall be computed at the rate fixed in the lease on the amount or value of production removed or sold from the lease. The words "removed or sold from the lease" were added after the word "production" in the 1946 amendment to the Act, August 8, 1946, 60 Stat. 951, giving thereby persuasive evidence that the Congress intended to ensure that royalty would be due only on oil and gas removed from the leasehold, not on the total oil and gas produced from the well. The operating regulations in 30 CFR 221.44 specifically state this exception.

The powers of the Secretary of the Interior are established and limited by the Mineral Leasing Act, as amended, and regulations lawfully adopted pursuant thereto. A regulation promulgated pursuant to the Mineral Leasing Act has the force of law. Chapman v. Sheridan-Wyoming Coal Co., 338 U.S. 621, 629 (1950). The Secretary of the Interior is bound by his own regulation promulgated pursuant to the Mineral Leasing Act so long as it remains in force since it has the force of law. McKay v. Wahlenmaier, 226 F.2d 35 (D.C. Cir. 1955).

The Oil and Gas Operating Regulations in 30 CFR Part 221 were issued pursuant to the authority granted the Secretary by the Mineral Leasing Act, 30 U.S.C. § 189 (1976). The Secretary, therefore, must abide by and follow these regulations in administering oil and gas leases issued under the Act. As above quoted, section 221.44 provides that gas used for production purposes is excepted from royalty due the United States. We think it is error by the Geological Survey in this instance to seek payment of royalty for such gas, contrary to the statute and regulations, notwithstanding the language in section 5 of the Unit Agreement.

To the extent that section 5 of the Elk Basin Unit Agreement purports to negate the express language of the Mineral Leasing Act, as amended, and the oil and gas operating regulations, it is a nullity.

The Elk Basin Unit Agreement provides in section 18 that all unitized substances produced from each participating area under the agreement shall be deemed to be produced equally on an acreage basis from the several tracts of land comprising the participating area. In Amoco Production Company (On Reconsideration), 35 IBLA 43 (1978), we held that it is proper to deduct the amount of gas used for production purposes on a lease from the gross allocation of gas to that lease under the unit agreement before making computation of royalty due the United States. We adhere to that position.

Our holding is limited to the question of the interpretation of the Elk Basin Unit agreement and applies only thereto. We do not express any opinion as to the effect of the Notice to Lessees (NTL-4) issued November 15, 1974, by the Geological Survey on the leases involved herein.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is reversed.

Douglas E. Henriques
Administrative Judge

I concur:

Frederick Fishman
Administrative Judge

ADMINISTRATIVE JUDGE BURSKI DISSENTING:

I agree with the majority that the relevant section of the Unit Agreement is section 21 relating to "Government Royalties" rather than section 19, "Royalties," found by the Director, Geological Survey, to be controlling. In the first place, inasmuch as the parties to the Unit Agreement, including the United States, have seen fit to have a separate section, specifically denominated as "Government Royalties," included in the unit agreement, it is somewhat anomalous to contend that the general "Royalties" provision nevertheless determines the royalties due to the Government. Moreover, section 22 of the Unit Agreement which deals with "Rental" contains specific reference to "land of the United States subject to this agreement." No similar reference is found in section 19. The conclusion is inescapable that the provisions of section 21, "Government Royalties," are the only provisions relevant to the instant appeal.

I disagree with the majority, however, in the interpretation of section 21. The majority focuses on the first sentence of the section which states: "Royalty due the United States on account of federal lands subject to this agreement within the unit area shall be computed as provided in the operating regulations." From this basis the majority argues that inasmuch as the applicable regulation, 30 CFR 221.44, clearly contemplates that gas used for production purposes on the leasehold is not subject to royalty, that there is nothing in the Unit Agreement which authorizes the imposition of royalty for gas so used.

I believe, however, that the crucial part of section 21 is the first proviso: "[P]rovided, that for leases on which the royalty rate depends on the daily average production per well, said average production shall be determined in accordance with the operating regulations as though all unitized lands within the participating area were a single consolidated lease." (Emphasis supplied.) It is uncontested that, to the extent that separate leases are involved, hydrocarbons produced on one lease may not be used, free of royalty, to produce oil or gas from a different lease. Cf. Amoco Production Company (On Reconsideration), 35 IBLA 43 (1978). The clear effect of the proviso is to obviate this problem within a participating area by treating all lands within the area as a single lease. 1/

1/ Admittedly, this proviso is also designed to allow allocation of production to all lands within the participating area, so as to avoid the problem which was manifested in Kirkpatrick Oil and Gas Company, 15 IBLA 216, 81 I.D. 162 (1974), where the Federal lessee was required, in the absence of an approved communitization agreement, to pay full Federal royalties on all production from a well located on the Federal land, while at the same time it was obligated under State law to compensate other parties to the unapproved communitization agreement for pro rata production.

Accepting this conclusion, however, I think it is impossible to then argue that appellant is also free to utilize production from one participating area in another participating area so long as both areas of use are within the vertical confines of the original Federal lease. Appellant, in effect, seeks to have it both ways. When it utilizes gas produced within the boundaries of the original Federal lease within the same participating area but on other lands, it argues that section 21 treats all lands within a participating area as a single lease. When it seeks to use gas produced from one participating area within the original Federal lease in another participating area also located within the original Federal lease, it then contends that it is still using the hydrocarbons within the same lease. I do not feel that such a result can be justified.

I would hold that section 21 mandates the treatment of participating areas as separate leases, and use of gas produced within one participating area for production within another participating area is use outside of the lease, for which royalty is due and owing. 2/ I, therefore, respectfully dissent.

James L. Burski
Administrative Judge

2/ This interpretation moots any question relating to whether or not the Unit Agreement violates the regulations, since 30 CFR 221.44 provides that royalty is due for gas produced "except gas used for purposes of production on the leasehold" (emphasis supplied), and the gas would simply not be used on the leasehold.